

IT 98-5

Tax Type: INCOME TAX

Issue: Math Error in Calculation of Return(s) Filed

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

TAXPAYER

No.
FEIN:

C. O'Donoghue
Admin. Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Charles M. Steines, Jones, Day, Reavis & Pogue for TAXPAYER, Inc.; Mr. Shepard K. Smith, Special Assistant Attorney General for the Illinois Department of Revenue.

Synopsis:

This matter comes on for hearing pursuant to the taxpayer's timely protest of the Notice of Denial issued on December 28, 1995 for the 1986 tax year. The Department refuses to refund the taxpayer's \$22,121.00 overpayment for 1986 because it contends the taxpayer owed tax and interest dating back to math error assessments relating back to the taxpayer's 1973 and 1974 Illinois Income Tax Returns and it properly used the 1986 overpayment to satisfy such liability. The taxpayer contends that the Department did properly offset its 1986 overpayment since it did not establish that proper math

assessments were created nor did it give proper notice of the assessments. At issue, is whether the taxpayer's protest of the Department claim denial for the 1986 IL-1120X allows the taxpayer to challenge the validity of the math error assessments. Following the submission of all evidence and a review of the record and the briefs filed herein, it is recommended that this matter be resolved in favor of the Department of Revenue.

Findings of Fact:

1. On or about September 30, 1987, taxpayer filed its Illinois Corporation Income and Replacement Tax Return for the 1986 tax year. Tr. p. 5; Taxpayer Ex. No. 1. The 1986 return reflects an overpayment of tax in the amount of \$22,121.00. ("1986 overpayment"). Taxpayer Ex. No. 1.
2. On June 22, 1989, the Department notified the taxpayer that its 1986 tax return had been audited. The Department reconfigured the taxpayer's unitary group and as a result, it was determined that the company had overpaid its 1986 Illinois income and replacement tax liability by an additional \$6,734.00. Tr. p. 6; Taxpayer Ex. No. 13.
3. On July 24, 1989, the taxpayer protested the Department's June 22, 1989 Notice of Deficiency and overpayment in the amount of \$6,734.00. Tr. p. 6; Taxpayer Ex. No. 3.
4. On November 21, 1989, taxpayer inquired of the Department why the uncontested portion (\$22,121) of its overpayment for 1986 had not been refunded. Tr. pp. 6-7; Taxpayer Ex. No. 9. The Department response indicated that the matter was under review. Tr. p. 7; Taxpayer Ex. No. 10.
5. On October 9, 1990, taxpayer wrote the Department to inquire about its 1986 overpayment and was again advised that the matter was under review. Tr. pp. 7-8;

Taxpayer Ex. No. 11.

6. On May 22, 1992, the Department issued a Notice of Decision addressing the taxpayer's July 24, 1989 protest. The decision accepted the taxpayer's composition of its' unitary group as it related to the 1986 taxable year. Tr. pp. 8, 16; Taxpayer Ex. No. 4; Dept. Ex. No. 6. The decision decided against the taxpayer with regards to the deductibility of taxes paid to foreign governments. Taxpayer Ex. No. 4; Dept. Ex. No. 6.
7. As a result of an Internal Revenue Service audit, TAXPAYER filed an Amended Illinois Corporation Income and Replacement Tax return for the 1986 tax year on November 3, 1994. This amended return reflected the adjustments made by the IRS to its 1986 federal return and renewed its claim for a refund of the 1986 overpayment. Tr. pp. 10, 16-17; Taxpayer Ex. No. 2.
8. The Department issued a Notice of Denial of the taxpayer's claim for refund of the 1986 overpayment on December 28, 1995. Tr. p. 12; Taxpayer Ex. No. 5; Dept. Ex. No. 1.
9. On February 5, 1996 the taxpayer protested the Department's December 28, 1995 Notice of Denial for the taxable year ending 1986. Dept. Ex. No. 2.

Conclusions of Law:

This matter comes to hearing as a result of the Department's denial of taxpayer's 1986 claim for refund in the amount of \$22,121.00. The Department does not dispute that the taxpayer overpaid its 1986 Illinois Corporation Income and Replacement Tax liability by \$22,121.00, nor does it dispute that the taxpayer sought a refund of this amount in its timely filed 1986 return. The Department, rather, refuses to refund this

amount because it contends the taxpayer owed tax and interest dating back to its 1973 and 1974 tax years and it properly used the 1986 overpayment to satisfy such liability.

Taxpayer's original 1986 tax return reflected an overpayment. When the taxpayer did not receive its refund after a normal period of time, it wrote to the Department inquiring as to the status of the refund. While in the midst of correspondence with the Department regarding the 1986 overpayment, the taxpayer underwent a federal audit. It timely filed a 1986 IL1120X reflecting the federal adjustments and renewing its claim for refund of the 1986 overpayment. Taxpayer Ex. No. 2. When the Department issued its Notice of Denial on December 28, 1995, the taxpayer timely filed its protest on February 5, 1996.

Taxpayer contends that it never received formal notification of the offset until 12/2/95, from the issuance of the Notice of Denial regarding its 1986 IL-1120X. The Department, on the other hand, contends that Notices and Demand letters went out at various dates. Taxpayer's arguments with regards to notice are misleading in that they serve to distract attention from the issue at hand; whether the taxpayer has properly challenged the 1973 and 1974 math error assessments by its filing of the 1986 IL-1120X reporting a federal change. To properly address this issue, an analysis must be made as to what the law requires when challenging math error assessments.

In 1973 and 1974, the record reflects that the taxpayer took a subtraction modification for foreign dividend "gross-up" income as defined in 26 U.S.C. Sec. 78 on its Illinois income tax returns, (Dept. Ex. No. 7), however, no section of the IITA provided a subtraction modification for Sec. 78 income for those years. Section 78 income was only allowed as a subtraction modification under the Illinois Income Tax Act

("IITA") for years ending after December 31, 1974. 35 ILCS 5/203(b)(2)(G) as amended by P.A. 79-1022 The Department assessed tax pursuant to IITA Sec. 903 which, during the tax years ending 1973 and 1974, read in pertinent part:

"The amount of tax which is shown to be due on the return shall be deemed assessed on the date of filing of the return (including any amended returns showing an increase of tax). In the event that the amount of tax is understated on the taxpayer's return due to a mathematical error, the Department shall notify the taxpayer that the amount of tax in excess of that shown on the return is due and has been assessed. Such notice of additional tax due shall not be considered a notice of deficiency nor shall the taxpayer have any right of protest."

35 ILCS 5/903.

Further, IITA Section 902 provides:

Notice and Demand. (a) In general. Except as provided in subsection (b) the Director shall, as soon as practicable after an amount payable under this Act is deemed assessed (as provided in Section 903), give notice to each person liable for any unpaid portion of such assessment, stating the amount unpaid and demanding payment thereof. ...

35 ILCS 5/902.

The statute does not allow the taxpayer to protest a notice and demand, rather, the taxpayer must pay the assessment and file a proper claim for refund.

Even assuming *arguendo*, that the taxpayer did not learn of the math error assessment until the 12/28/95 Notice of Denial, the taxpayer did not file a proper claim within the applicable statute of limitations. Upon learning of the offset, on 12/28/95, the taxpayer should have filed its claim with regards to the taxable years ending 1973 and 1974 within one year from this date pursuant to 35 ILCS 5/911(a)(1). Taxpayer did not file a claim within this time period and as a result, it may not challenge the math error

assessments through its protest of its 1986 claim for refund.

The Department regulations provide guidance to taxpayers when filing their claims. Section 9400(f)(6) specifically states that informal claims such as letters from the taxpayer are insufficient for the purpose of establishing or extending any of the limitations in IITA Section 911... . Furthermore, Section 909 (d) of the Act requires that:

Every claim for refund shall be filed with the Department in writing in such form as the Department may by regulations prescribe, and shall state the specific grounds upon which it is founded.

Taxpayer's claim was filed as a result of federal adjustments, and did not properly challenge, nor state its grounds for contention of the 1973 and 1974 assessments.

In support of its position, the Department relies on Dow Chemical v. Department of Revenue, 224 Ill. App. 3d 263. In Dow Chemical, the taxpayer had originally filed its 1975 through 1978 tax returns on a separate apportionment basis. The Department audited these returns and proposed an additional liability and issued a Notice of Deficiency on December 1979 which Dow timely protested. Subsequently, the parties determined that the case should be returned for a reaudit. The reaudit results were finalized in December 1983 and revealed that the taxpayer had overpaid its Illinois tax liability with regards to the years in question. The taxpayer then filed an amended protest and requested that the overpayment be returned. This request was denied since the Statute of Limitations had expired for the years involved. The Illinois Appellate Court ultimately found in favor of the Department and held that although the Department has a duty to refund overpayments, taxpayers have the duty to file proper claims to receive those refunds.

The taxpayer argues that Dow Chemical differs from the case at hand in several important respects. First and foremost it argues that the taxpayer seeks to have its 1986 overpayment refunded and notes that both the original 1986 claim and the 1986 IL1120X were filed timely. This distinction is irrelevant, because when the taxpayer filed its IL1120X for the tax year ending 1986 it was filing its amended return pursuant to its federal adjustments. The taxpayer argues that when it received proper notice of the offset in 12/28/95, a proper claim had already been filed, thus, the taxpayer was not obligated to file yet another claim for the 1986 tax year. This position, however, ignores the Department's regulations and the court's holding in Dow Chemical.

The taxpayer may not use its 1986 IL-1120X, filed pursuant to federal changes, as a vehicle to challenge other issues. The Department did not challenge the amounts claimed on the taxpayer's 1986 IL-1120X; the Department is keeping the taxpayer's overpayment due to an issue separate and apart from the adjustments which gave rise to the filing of the 1986 IL1120X. To put the math error assessments in issue, a proper claim for refund for 1973 and 1974 should have been filed, stating the specific grounds upon which it contends that the math error assessments were unfounded. *See*, 86 Ill. Adm. Code Ch. I, Sec. 100.9400(f)(5).

Taxpayer also contends that the 1973 and 1974 math error assessments were invalid in that a state cannot tax Sec. 78 income if it does not also tax domestic dividends following the Supreme Court's holding in Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance, 505 U.S. 71, 112 S.Ct. 2365 (1992). Taxpayer also cites Dart Industries v. R. Gary Clark, Tax Administrator, 657 A.2d 1062 (R.I. 1995) a case which relied on Harper v. Virginia Dept. of Revenue, 113 S. Ct. 2510 (1993). In Harper the

court noted that “the controlling interpretation of federal law, must be given full retroactive effect in all cases still open on direct review”

In the instant matter, the issue of whether the math error assessments were valid is not “open and on direct review.” Other courts have addressed this issue. In Atkins v. Department of Revenue State of Oregon, 13 OTR 65 1994 Ore Tax Lexis 25 (Ore. Tax Court 1994), the taxpayer filed an amended tax return contending that their federal retirement benefits were not subject to tax by Oregon. Oregon audited the return and denied the exclusion. In 1994, the Oregon Tax Court, applying Harper, *supra*, granted the taxpayer’s claims for refund which was “open on direct review.”

In the case at hand, a proper claim seeking a refund of the Section 78 income was never filed; the only amended return at issue was the 1986 tax return filed to reflect the federal changes which are separate and unrelated to the Sec. 78 income. Thus, to put the Sec. 78 income subtraction modification “open and on direct review”, a proper claim should have been filed.

Wherefore, for the reasons stated above, it is my recommendation that the Department’s claim denial be upheld.

Christine O’Donoghue
Admin. Law Judge